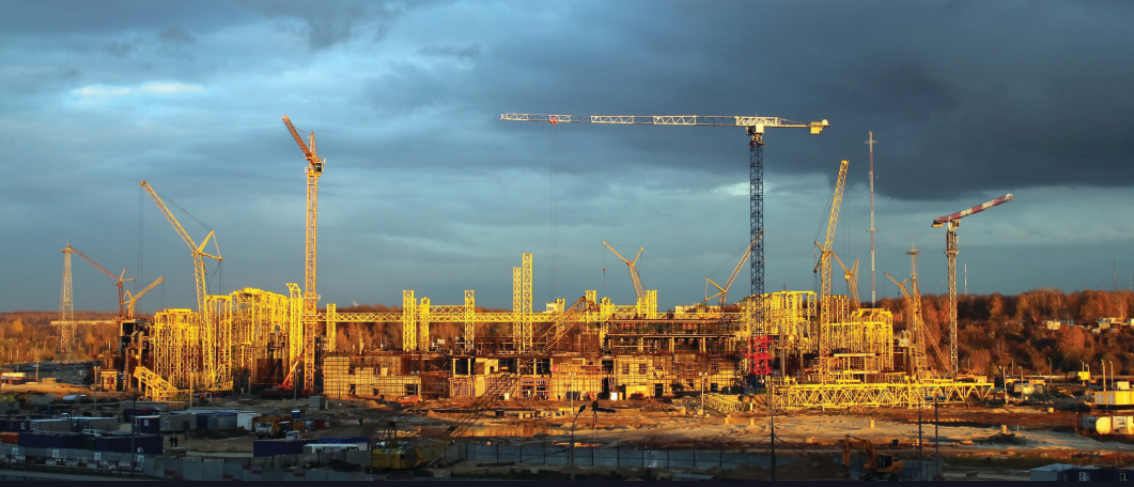

PPP – PUBLIC-PRIVATE PARTNERSHIP

A guide to understanding how PPP works in Brazil

Fernando Vernalha Guimarães

VG&P
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Editor FERNANDO VERNALHA GUIMARÃES
Graphic Design and Layout MANOELA LEÃO. Gusto Editorial e Design
Translation and Proofreading DUO TRANSLATIONS

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PPP – PUBLIC-PRIVATE PARTNERSHIP
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INTRODUCTION: UNDERSTANDING THE PUBLIC AND INFRASTRUCTURE MARKETS IN BRAZIL

Brazil currently demands significant investments in infrastructure. To overcome logistical bottlenecks and advance sustainable growth in Brazil, infrastructure projects have to be developed in strategic areas in the next few years, particularly for the transport sector (but also in areas such as prisons, urban mobility, regional development etc.) For such purpose, the Brazilian government depends on the participation of the private sector, which plays an important role in the recovery and expansion of public infrastructure.

As a rule, infrastructure projects are managed by the public sector and sent out for bidding so that the best bid can be selected. The main types of contracts are the common public service concession and the Public-Private Partnership (which comprises two types of concession: sponsored concession and administrative concession). Thus, there are three main models of infrastructure contracts in Brazil: (i) common public service concession, (ii) sponsored concession and (iii) administrative concession. The main difference is that the common

concession implies financially self-sufficient businesses (which generate user fees, when such revenue is enough to support the business and generate profits for the concessionaire), while the sponsored concession takes into account unprofitable businesses, which require Government subsidies; administrative concessions are contracts in which the entire fee is paid by the Government, and there is no fee to be paid by service users.

How can this market be accessed? How can a company apply to be a concessionaire in the public sector?

As aforementioned, many infrastructure projects are managed by the public sector and sent out for bidding. In this case, companies will have to apply to bid for procurement and compete with stakeholders to award the tender for the concession. This is the conventional way to bid for a concession contract.

There are also cases where the private sector can offer the Government a project proposal. This can occur either from a call of the government for companies to propose projects or spontaneously by a company with particular skills and knowledge that may be of interest to the public sector. There is no purposeion, under the current regime of PPPs and concessions, to companies proposing development projects to the Government in their areas of expertise, so that this project can be approved and sent out for bidding afterwards. This is what is called CEI (or Call for Expression of Interest). In these situations, the private company asks permission to develop a particular project, indicating costs and execution time. If the project is authorized and designed, and subsequently approved by the Government, it will be put to public tender. The tenderer can bid for its own project for the construction or execution of the services provided and, if it does not win the bidding, it will be reimbursed by the winning company for project design costs. It

is a good regular practice to encourage specialized companies to propose projects of interest to the public authorities, which lack the same skill and expertise to do so.

This project proposal method (CEI) has increased significantly in recent years, in view of the interest of many business groups to do business with the Government. And given the urgency and lack of investment in infrastructure, it is likely that the CEI procedure is an increasingly important channel to stimulate the implementation of well-designed projects that can attract investments for public infrastructure in Brazil.

1. CONTEXTUALIZING PPPS

The Brazilian model of public-private partnerships, as established by Law no. 11.079/2004, is inspired by international experiences with the so-called public-private-partnerships. In the international experience, PPPs are a model of long-term administrative contract where financial capital can fund and execute public works and projects and provide services of collective interest. Because the Government is unable to finance infrastructure projects, the private sector can share risks and make enough investments to foster the growth of public infrastructure.

The PPP model has spread in Europe (based on the British program of the private finance initiative - PFI) as a means of avoiding budget constraints placed by the Treaty of Maastrischt and the Stability and Growth Pact, which imposed a limitation on the public deficit of the member states of the EU[1]. PPPs were considered an appropriate contractual ins-

1. One of the convergence criteria established by the Treaty (to enter the third EMU stage) was that the ratio of budget deficit of the member States relative to the Gross Domestic Product (GDP) must not exceed 3%, and the ratio of public debt relative to the GDP must not exceed 60%.

trument to enable investments in infrastructure without the corresponding indebtedness of the Government; thus, the financial assets regarding the implementation of infrastructure projects can be included in the accounts of the private partner. Therefore, PPPs became a technique that allowed the investments required in the construction of large infrastructure projects to be placed off the balance sheet of the Government[2]. When the investments were transferred to the private capital, there was no need to include these assets in the public balance sheet, which prevented these investments from having an impact on the debt of European countries. This scenario has seen the creation of what is conventionally called public private partnership.

The situation was not different in Brazil, which had to use this new model in order to overcome the rigidity of its contractual models and allow the cooperation between the State and the private sector in financing the provision of services and the implementation of long-term projects. The creation of the Brazilian PPP model is basically associated with the search for private sector investments in infrastructure (given the urgency to overcome bottlenecks in logistics and, thus, foster Brazil's

2. As stated by Ana María Juan Lozano and Jesús Rodríguez Márquez, "... el debate sobre las modalidades de financiación privada de infraestructuras y servicios se viene enmarcando em la búsqueda de soluciones a las restricciones presupuestarias. De este modo, cuando en la actualidad se analizan las distintas alternativas que se barajan en el ámbito de las Administraciones Públicas se viene haciendo hincapié, em numerosas ocasiones, em su utilidad para mantener el esfuerzo inversor sin comprometer las exigencias presupuestarias derivadas de nuestra pertencia a la Unión Europea". La Colaboración Público-Privada em La Financiación de Las Infraestructuras y Servicios Públicos. Una Aproximación desde los Principios Jurídico-Financieros. Madrid: Instituto de Estúdios Fiscales, 2006, pp. 26 e 27.

growth), especially in view of various difficulties and financial constraints which are typical of the public sector. Therefore, it was necessary to implement a regime primarily focused on the legal security of settlements, allowing the private capital to finance public services and long-term projects.

In this context, several state and municipal laws, as well as Federal Law. No. 11.079/2004, were issued, establishing general (and federal) rules for bidding and procurement in public-private partnerships.

Under National Law, PPPs emerge as two new types of concession: sponsored concession and administrative concession. The aim of the legislator with the enactment of the Brazilian PPP Law and the creation of new types of contract was to expand the use of the concession model, extending its scope to new purposes. On the one hand, by means of State financing, the sponsored concession ensures the feasibility of projects that did not use to be financially self-sufficient. On the other hand, and under the model of administrative concession, the logics of concessions (especially when it comes to the technical management of long-term assets and services) shall be extended to services and other purposes whose procurement was previously regulated only by Law no. 8.666/93.

2. DEFINITION OF PPP UNDER BRAZILIAN LAW[3]

Although the term public-private partnership has been traditionally used in a broad sense in our judicial doctrine (to explain a wide range of long-term settlements between the Government and private parties), the enactment of Law 11.079/2004

3. For further information on PPPs, refer to Vernalha Guimarães, Fernando. Parceria Público-Privada. São Paulo: Saraiva, 2012.

and the creation of the Brazilian PPP model gave the term a specific legal connotation to refer to new forms of concession: sponsored concession and administrative concession.

Under the model introduced by Law no. 11.079/2004, public-private partnerships are government contracts for service provision, with or without public service delegation, and may involve other integrated activities, whose remuneration of the private partner is composed partially or entirely of financial consideration (monetary or otherwise), to be provided upon the provision of the service as they are made available to users. Such contracts will always be long-term (with a minimum term of five years for the provision of services and maximum of 35 years for the completion of the PPP), with a minimum value of BRL 20 million; risks will be shared between the public partner and the private partner.

This definition can be further specified to explain the two respective legal manifestations introduced by Law no. 11.079/2004: sponsored concession and administrative concession.

The *sponsored concession* is the kind of concession for service provision or public works (governed by Law no. 8.987/95) where the remuneration of the concessionaire is necessarily composed of continuous monetary consideration provided by the Government. It is a contractual arrangement geared to allow the integration of subsidies continuously provided by the Government in the remuneration of the concessionaire. The provisions of Law no. 11.079/2004 and, alternatively, the discipline of Law no. 8.987/95, are applicable to this type of contract.

In contrast, an administrative concession is an government contract for service provision (not necessarily public services), and it may involve other provisions such as the supply

of assets and / or execution of works, with the remuneration of the private partner being paid exclusively by the Government by means of consideration that may be undertaken in various legal forms allowed by the legal system. The service that is the purpose of this concession may be made available directly to the Government or to the users, in which case the Government will be an indirect user. The provisions of Law no. 11.079/2004, Articles 21, 23, 25, 27 and 39 of Law no. 8.987/95 and art. 31 of Law no. 9.074/95, are applicable to the administrative concession.

3. PPPS AND POSITIVE LAW

In Brazil, PPPs are defined and provided for by Federal Law. No. 11.079/2004, which contains general rules (and also special rules, narrowly applicable to the Federal Administration) on the matter.

In addition to the enactment of the Brazilian PPP Law, there are several infralegal regulations issued over the last few years that are pursuant to its legal discipline. Among them, Administrative Rule no. 614/2006 is particularly important. It regulated Article 25 of Law no. 11.079/2004 and established the general rules for the consolidation of public finances applicable to public-private partnership contracts[4].

At the constitutional level, there is no explicit reference to

4. Refer to Decree no. 5.385/2005 (complemented by Decree no. 6.037/2007), which provided for the setup of the Steering Committee of Federal Public-Private Partnerships (CGP), as well as Decree no. 5.977/2006, which regulated art. 3, main clause and § 1, of Law no. 11.079/2004, which provides for the presentation of projects, studies, surveys or research to be used in models of public-private partnerships within the Federal Government. There is also Resolution no. 1/2005, issued by the Steering Committee of Federal Public-Private Partnerships, which provided for the Guarantee Fund of Public-Private Partnerships – (GFP).

these kinds of government contract - which is very understandable. They originate from Article 175 of the Constitution, which provides the feasibility of the Public Administration to delegate the provision of public services to private companies under concession, and in Article 37, Section XXI, which establishes the principle of recourse to the administrative contract aiming at the implementation of state tasks. Article 22, Section XXVII, also establishes the exclusive authority of the Federal Government to legislate on general rules in terms of government contracts, a legal provision that gives the Federal Government legitimacy for the legislative setting of new types of concessions, at least as regards their core features.

4 . CONFIGURATION OF THE TYPES OF PPPS

Prior to the analysis of the legal regime of PPPs, it is important to understand the features and the structure of each of type of PPP.

4.1 SPONSORED CONCESSION

The sponsored concession is an administrative concession contract which necessarily presupposes user fees with added monetary considerations paid by the Government. It is a (common) public works concession (execution of public works followed by economic exploitation of services by the concessionaire) or public service (delegation of the management of public services paid by user fees, preceded or not by the execution of works) as long as it is added to the revenue collected from user fees (monetary consideration of the public partner to the private partner).

While the common public service concession (regulated by Law no. 8.987/95) requires financially self-sustaining settle-

ments and does not allow the integration of state subsidies[5], the sponsored concession is intended to offer feasibility to unprofitable concession projects which depend on subsidies to become economically profitable. There are services and public works which, though economically unprofitable, bring positive benefits to society, with high social returns. By means of sponsored concession, the State makes them feasible by creating a pathway for continuously financing the implementation of the public service under concession. This is the key purpose of sponsored concessions.

4.1.1 THE REMUNERATION SYSTEM OF THE SPONSORED CONCESSION

Sponsored concessions are comprised of a mixed system of compensation: (a) monetary considerations paid by the Government + (b) fees collected directly from service users and (occasionally) (c) alternative revenues which are ancillary to the concession[6]. Fees will necessarily be collected from users, and monetary considerations by the Government will be continuously added to the economical-financial setting originated in the concession, with acceptance of alternative revenues arising from projects associated with the concession.

5. The inclusion of state subsidies into the remuneration system of the common public service concession was perfectly feasible from the exegesis of art. 11 of Law no. 8.987/95. However, with the advent of Law no. 11.7079/2004, and the enactment of the law on the sponsored concession, the legislator aimed to relate this circumstance to the legal configuration of this new type of concession, restricting the common concession in order to take financially self-sufficient settlements into account (with prior consideration of alternative private revenues).

6. The feasible integration of alternative revenues produced by associated businesses into the remuneration system of the sponsored concession is due to the applicability of article 11 of Law no. 8.987/95 to this event.

As a typical feature of the sponsored concession, this kind of (monetary) consideration can be of any nature permitted by law (as long as it involves cash consideration), according to Section V of article. 6 of Law no. 11.079/2004. Among the types of consideration by the public partner under Law no. 11.079/2004 (art. 6), only the "standing order" and the "grant of non-tax credits" are closely associated with the concept of monetary consideration. The other types do not have this nature.

It is worth noting that monetary consideration by the public partner as a formative element of the remuneration of the concessionaire differs from the legal notion of subsidy. This caveat is not idle, because in Brazilian law, subsidies and expenses resulting from procured services are treated unmistakably also for tax purposes.

Subsidies, as current transfers, are explicitly different from expenditures originating from direct consideration for assets or services (§ 2. of art. 12 of Law no. 4.320/64); thus, they can be distinguished from consideration provided by public authorities under government contracts in general. Current transfers are not characterized as payments on account of procured assets and services purchased. They are allocations that fulfill different purposes. A similar conclusion is reached regarding the so-called subsidy-investment.

It should be noted that art. 7. of Law no. 11.079/2004 provides that the consideration by the Government must be preceded by the provision of the service contemplated by the contract of public-private partnership, which indicates that the obligation is justified as a counterpart to the provision of the service (or available portions of the service). It is, thus, the payment of the obligation (incurred by the concessionaire) of provision of the service. This characterization is incompatible

with the concept of subsidy, which - as explained above - does not qualify as a financial compensation for services performed by the private party.

In addition, the remuneration system of sponsored concession requires specific law authorizing the cases in which the amount of the consideration by the public partner exceeds 70% of the remuneration due to the private partner. The requirement is stated by § 3 of art. 10 of Law no. 11.079/2004 and is associated with the fiscal control of the PPP. The purpose of the rule is the preservation of public finances, restricting the administrative discretion as to the big and long term commitment of resources and assets. The requirement of prior law limits administrative autonomy and ensures the co-responsibility of the Legislature on the decision to allow the participation of the state in an economic commitment of this magnitude[7].

4.2 ADMINISTRATIVE CONCESSION

As defined by the Brazilian PPP Law, the administrative concession is the administrative contract of concession concluded between the public administration and the third party (private partner), whose purpose is the provision of services of which the Public Administration is the direct or indirect user, even if involving the execution of works or the supply and installation of assets.

7. It would not be unreasonable to conclude that, although not generally applicable to administrative concessions, due to the lack of explicit legal provision, the precedence of specific law must be a requirement for events of administrative concession whose purpose is economic public services. For further information, refer to Vernalha Guimarães, Fernando. "Parceria público-privada - necessidade de autorização legislativa para a concessão patrocinada em que mais de 70% da remuneração do parceiro privado seja paga pela administração pública e sua (in) aplicabilidade às concessões administrativas", In Revista Zênite - Informativo de Direito Administrativo e IRF IDAF, Curitiba: Zênite, v. 8, n. 88, 2008.

It is, therefore, an administrative contract for the provision of services - not necessarily public services (in most cases, they will not actually be) - which may involve other activities such as the supply of assets or execution of works, in which the Government will be responsible for the remuneration of the private partner. Although legislatively qualified as a concession, there are no fees in the administrative concession, and the source of funding of remuneration of the concessionaire will be the public considerations[8] (in one or a few of the forms permitted by Article 6 of Law no. 11.079/2004)[9].

As regards its financial structure, the administrative concession is intended as a way to finance public projects and services of collective interest by means of private capital. Through the requirement contained in the respective Law that the public consideration is to be made only after the provision of the available service (art. 7, Law no. 11.079/2004), the private partner is allowed to fully finance the infrastructure needed to implement the service. Thus, whenever the provision of service implies the execution of works or the supply of assets, so that such service can be accomplished, there is a particular technique of adjourned financing, which allows the Government to abide by the cost of execution included in the project and diluted in the cost (price) of service provision.

In comparison, under the logic of long-term asset manage-

8. It can be observed that, unlike the sponsored concession, the setup of the administrative concession does not require monetary consideration of the private partner; any legal form of consideration can be accepted if provided for in art. 6 of Law no. 11.079/2004.

9. In the administrative concession, the remuneration of the private partner can be also composed of the alternative revenues provided for in article 11 of Law no. 8.987/95.

ment, the administrative concession will allow the private partner to take the risks and responsibilities which are inherent to concessions. As PPPs are long-lasting, the works and assets implemented to make the service available and readily usable will be managed in the long term by the private partner, who will take the risks inherent to the maintenance and conservation of such assets.

As summarized by Carlos Ari Sundfeld, the legislative option of designating PPPs as concessions was not only terminological: "The intention was to employ, in new purposes, the contractual structure and economic logic of contracts covered by the Law on Concessions. Therefore, PPP contracts were subject to this law"[10].

4.2.2 THE PURPOSE OF ADMINISTRATIVE CONCESSIONS

From the point of view of the activities that may constitute its purpose, administrative concessions will necessarily involve the provision of services, which may or may not be associated with other provisions such as the supply of assets and execution of works[11]. Except for activities considered to be non-delegable, any activity can be contemplated by this kind of concession.

From the perspective of the identity of the contractor, it is observed that the administrative concession may involve activities provided to the Government or directly to service users (in which case the Government will be the indirect user).

10. "Guia Jurídico para as Parcerias Público-Privadas" *In Parcerias Público-Privadas* (Ed. Carlos Ari Sundfeld). São Paulo: Malheiros, 2005, p. 33.

11. As explained further below, Law no. 11.079/2004 determines that the execution of the works, the supply of assets or the supply of labor, when considered alone, cannot be the sole purpose of PPPs.

When the direct user of the service is the Government, the services will not be available to individual users (thus, they will not be subject to user fees), as activities proper of the contract of service governed by Law no. 8.666/93. Such activities will be equivalent to those traditionally hired by the Government under contract work. One example is an administrative concession for constructing and equipping prisons, with the provision of hotel services (restaurant, laundry, cleaning, maintenance of infrastructure, etc.) and perhaps activities that directly support the exercise of police power as well (for example, the implementation of technological services such as CCTV prison surveillance, among others). Several examples could be mentioned, such as providing urban cleaning equipment and services, or constructing and equipping data processing centers for the Government, with the provision of information technology services, etc.

When provided indirectly to the Government, services will be directly offered to users, and the Government becomes the indirect user. In this case, the purpose of the administrative concession may involve either (i) the provision of services that are not subject to user fees, and (ii) the provision of economic public services.

The first group basically comprises social services such as health and education, whose free-of-charge provision by the Government is mandatory by the Constitution. The administrative concession allows the management of these services to be transferred to the private partner, which will provide users directly, obtaining remuneration paid solely by the Government. Examples include the administrative concession for constructing (and/or equipping) hospitals associated with the operations of laboratory and medical services and maintenance of infrastructure, as well as the construction of schools,

with the provision of associated services, such as restaurants, canteens and maintenance of infrastructure.

The second group comprises the so called economic public services. Here, either the common public service concession or the sponsored concession could be operated in full technical condition, but the State makes a political decision to exempt service users from fees, and the project is entirely funded by the Government. The most obvious example is the road concession at no cost to the user – the model internationally known as shadow toll, practiced in countries such as England, Finland, Portugal[12] and Spain[13]. In this case, there is a settlement whose purpose is similar to that of the common public service concession, where the management of a public service subject to user fees is transferred to the private partner, who will provide the service directly to users. It is intended to resemble the user fee system, but the difference is that the fee is to be paid by the Government itself rather than by service users.

12. The shadow toll model was introduced in Portugal after Decree-Law no. 267/97 was issued; it transferred the construction, maintenance and commercial exploitation of highways to the private sector against payments made exclusively by the Government. These concessions were known under the acronym SCUT ("sem custo para o utilizador", i.e. no collection of tolls from users).

13. In Spain, Law 13/2003 adopted this type of remuneration within the public works concession. Article 246.4 of this Law determines that "La retribución por La utilización de la obra podrá ser abonada por la Administración teniendo em cuenta su utilización y em el forma prevista em el Pliego de cláusulas administrativas particulares". An experience with the shadow toll before the advent of Law 13/2003 (which rules over public works concessions), was the concession for the construction, maintenance and commercial exploitation of the Rodovia do Nordeste (Section C-415) in Murcia. For an analysis of this concession (from an accounting perspective as well), refer to Pina, Vicente e Torres, Lourdes. *La Iniciativa Privada en El Sector Público: Externalización de Servicios y Financiación de Infraestructuras*. Madrid: Aeca, 2003, p. 73 and the following pages.

5. RELEVANT ASPECTS OF THE LEGAL REGIME OF PPPS

In addition to the fact that (common) concessions are legally treated on common grounds (reflected in the application of provisions of Law no. 8.987/95, which does not conflict with the discipline of Law. 11.079/2004), the PPP regime comprises a specific discipline applicable to sponsored and administrative concessions. The differences of the legal regime regarding these kinds of concession lie in the legal provisions applicable only to the user fee system. Such provisions do not apply to the administrative concession, because no fees are collected in this type of contract. Moreover, there is a common discipline to administrative and sponsored concessions which complies with the legal regime of the PPP. It is worth taking the basic aspects of this regime into further consideration.

5.1 LIMITATIONS ON THE PURPOSE OF PPPS

The Brazilian PPP Law has established restrictions on the purpose of such contracts. The use of the PPP model is clearly not allowed for settlements whose purpose is only the supply of labor, the supply and installation of equipment or the execution of public works (Section III, § 4. of art. 2. of Law 11.079/2004). Such restrictions are aimed primarily at administrative concessions, which involve varied purposes (albeit necessarily composed of services).

It is not legally feasible, thus, to implement a PPP for constructing public works or supplying and installing assets exclusively. A PPP is even less viable for the supply of pure and simple labor, i.e. for the so-called "hiring".

The prohibition that administrative concessions contemplate exclusively the execution of public works or the

supply and installation of assets aims to protect the model from arrangements which require the combination of purposes under the logic of private financing of public assets. During the creation of the Law no. 11.079/2004, there was a great deal of debate on the risk of overuse (and misuse) of PPPs to purposes devoid of features that authorize the application of a special legal regime, also built from a system of special guarantees to the private partner. The aim of the legislator was to reserve the regime of the PPP to arrangements implying investments made and managed by the private partner.

The most obvious case relates to the execution of works, which needs to be associated with service provision to compose a possible purpose for PPPs. The idea is that the execution of works and the provision of infrastructure are the entire responsibility of the private partner, who will be in charge of managing and operating these assets in the long term, in the provision of services associated with them. The cost of the works and assets required to implement the services will be added to the cost of the service. For this reason, it makes sense that, under this model, the provision of services is necessarily integrated into the purpose of a PPP.

Admittedly, however, the provision of services can be the single purpose of a PPP (of an administrative concession, as well). Anyway, it does not comprise only simple services such as the hire of labor, etc. The provision of services as the purpose of an administrative concession is to be understood from the concession logic that characterizes this concession, and priority should be given to the results to be achieved – rather than the means.

5.1.1NON-DELEGABLE ACTIVITIES

In addition to the limitations on the type of provision, Law no. 11.079/2004 cautioned in art. 4, Section III, the unfeasibility of including allegedly non-delegable activities[14] in the purpose of PPPs.

Although some mandatory and enforcing decision-making authority of the Government cannot be delegated, there are situations when individuals can perform instrumental and incidental activities to the exercise of such authority. The judicial doctrine has been examining the issue[15]. Where the acts are merely material and instrumental to the legal manifestation of exclusive or typical (preparatory or successive) competences of the State, there will be no allocation of decision-making authority on the reasons that interfere in the ownership and freedom of private parties[16]. These activities are considered to be "instrumental services" to the legal expression of police power. Under these conditions, private management is considered to

14.As stated by law: *non-delegability of the following function: regulatory, judicial, exercise of police power and other activities exclusive of the State.*

15. Dallari, Adilson Abreu."Credenciamento", *in Estudos em homenagem a Geraldo Ataliba*. São Paulo: Malheiros, 1997, pp. 51 and 52. Marques Neto, Floriano de Azevedo. "A contratação de empresas para suporte da função reguladora e a "indelegabilidade do poder de polícia", *in Revista Trimestral de Direito Público* n° 32/2000. São Paulo: Malheiros, 2000, pp. 68 to 71. Justen Filho, Marçal. *Teoria Geral das Concessões de Serviço Público*, São Paulo: Dialética, 2003, p. 102. Bandeira de Mello, Celso Antônio. "Serviço público e poder de polícia: concessão e delegação", *in Revista Trimestral de Direito Público*. n° 20. São Paulo: Malheiros, 1997, pp. 25, 26, 27 e 28.

16. For further information, refer to Vernalha Guimarães, Fernando. "As parcerias público-privadas e a transferência de atividade de suporte ao poder de polícia – em especial, a questão dos contratos de gestão privada de serviços em estabelecimentos prisionais". *Parcerias público-privadas*. (Ed. Carlos Ari Sundfeld). São Paulo: Malheiros, 2005.

be feasible. Exceptionally, the legal exercise of police power by a private party has been allowed by an (associated) legal act.[17]

This issue is even more important in PPP programs applied to prisons. In the wide range of tasks that can characterize the purpose of an administrative concession, there are activities that relate immediately to the exercise of police power, which makes them non-delegable. Prison security is an example, because such services are directly associated with the maintenance of prison discipline. However, this is not true of all the activities that could qualify as relevant to prison security. There are portions of security that can be transferred to private parties with no offense to any constitutional or infraconstitutional rule. Such activities are those merely aimed at (technically) supporting the provision of security and surveillance services, and do not assume the power of coercion or protective function of the sentence. For example, the implementation of CCTV prison surveillance is an activity that can be managed by a private company. It is an automated technical service, which merely supports the very exercise of surveillance and security.

5.2 LIMITS ON THE VALUE OF PPPS

The Brazilian PPP Law excludes the suitability of partners whose contract value is below BRL 20 million, according to Section I of § 4 of art. 2 of the Brazilian PPP Law. This statute of limitations is contained in the part of the Law dedicated to the general rules.

17. It is argued, however, that in this event there is no "delegation" of police activity, but rather a mere "management relationship" (where the government itself exercises the police power by means of equipment in the custody and preservation of private parties). Bandeira De Mello, Celso Antônio. "Serviço público...", pp. 27 and 28.

The aim of the legislator seems to have been to restrict the use of the model to projects of significant amounts in view of three fundamental purposes: (i) to avoid applying the model to purposes which, from the perspective of economies of scale, do not justify the high costs of the project (which are recurring in structural projects); (ii) to avoid using the model in ordinary and simplified contracts, which must be the disciplined by the regime of Law. 8.666/93; (iii) to prevent entities without financial stature from entering into contracts where the State continuously has long-term financial commitments, as in a PPP.

Naturally, establishing a minimum value of BRL 20 million eliminates the possibility of PPPs for most municipalities, which do not have such a great financial stature. The restriction on the suitability of PPPs to small municipalities has raised a discussion about whether the law, Section I, § 4 of art. 2, is a general or special one.

5.3 THE REGIME OF TERMS IN PPPS

As observed in the common concession contracts, PPPs should have a specified length of time. The minimum term of the contract will be five years, and the period of service provision cannot be less than five years. The maximum term of the PPP agreement will be 35 years, including a possible extension (Section I of Art. 5).

The Law provides that the period shall be determined in a manner consistent with the amortization of realizable investments in the concession. This is logic is inherent to the concession model. As a model of contract that requires large investments, the concession requires an appropriate period for

its amortization[18]. This is precisely the reason why the period of operation of the service is an important element of the economic and financial setting of PPPs.

5.4 THE LEGAL TREATMENT OF THE REMUNERATION OF THE PRIVATE PARTNER

Although the remuneration system of the sponsored concession is different from that of the administrative concession, there is a common discipline provided for in Law no. 11.079/2004, which imposes important limitations on the types of PPP as regards the remuneration of the private partner, as explained below.

5.4.1 THE CONSIDERATION OF THE PRIVATE PARTNER MUST BE PRECEDED BY THE PROVISION OF THE SERVICE

Under the main clause of Art. 7. of Law no. 11.079/2204, the consideration by the Government must be preceded by the provision of the service under the contract for public-private partnership, and (as observed in the sole paragraph of this article), under the terms of the contract, the Government has the option to pay the consideration on the available portion of that service.

This rule is intended to ensure the exclusive participation of private capital in the implementation of the infrastructure required for service provision. Thus, the state subsidies remain outlawed at the stage of financing required for service

18. For further understanding of the relationship between remuneration/amortization, refer to the book *Direito das Concessões de Serviço Público: Inteligência da Lei n. 8.987/95 (Parte Geral).* São Paulo: Malheiros, 2010, pp. 159 and following pages, by Egon Bockmann Moreira.

provision (or available portion of the service). The participation of the public partner in the remuneration of the concessionaire shall be effective only when the service is delivered (after it is made available), when the infrastructure will be fully operative and subject to commercial exploitation/management by the concessionaire.

The restriction indicates the acceptance of a certain method for financing public projects, preventing the Government from spending resources to implement the works required for the management-operation of the service. The aim of the legislator was to allocate the use of public resources to subsidize or fund the service itself, while the concessionaire is made responsible for financing the infrastructure required for readily using the service. The condition authorizing the implement of the consideration of the public partner will be the delivery of the available portion of the service.

5.4.1.1 THE POSSIBILITY OF INTEGRATING PUBLIC FUNDS BEFORE THE AVAILABILITY OF THE SERVICE BY THE PRIVATE PARTNER

Law 12.766/2012 brought significant changes to the operation of PPPs, as regards both the Government's financial participation in the funding of reversible assets, and the taxation of the respective amounts. In the new Law, §s 2, 3 and 4 of art. 6 and § 2 of art. 7 of Law no. 11.079/2004, allow the PPP contract to provide for "allocation of resources" in favor of the private partner, as authorized by the call for bids (or specific law in respect of contracts concluded prior to August 8, 2012), to be provided during or after the stage of investment, specifically for works and procurement of reversible assets. The purpose of these provisions is, on the one hand, to allow potentially avai-

lable public resources to be applied when implementing the infrastructure, thereby reducing the need for investments by the concessionaire and relieving financial costs of the project, and on the other hand, to allow adjournment of taxes on the remuneration of the private partner.

Thus, it will be perfectly legitimate for contributions of public resources to compose the remuneration of the private partner, both along the investment phase (before the readily availability of the service), and subsequently as well. It is true that the contributions which are characterized as consideration - after all, this may be regarded as a type of allocation of resources - cannot be made before the availability of the service, under the main clause of art. 7 of Law no. 11.079/2004. However, nothing prevents other contributions from arising at the stage of investment, as long as they meet the conditions established by law. There are two fundamental conditions to enable the contributions: (i) previous authorization by a specific law, in the case of contributions associated with contracts concluded prior to August 8, 2012, (ii) use of contributions for constructing or acquiring reversible assets.

The purpose of these rules, by allowing such contributions, is to alleviate the financial costs of the PPP project. It should be noted that the legal framework for PPPs emerged in a historical moment in which the public sector experienced several budget constraints, which hindered, and in many cases prevented, public financing of infrastructure projects. The private partner was expected to make all investments (concentrated at the beginning of the execution of contracts) required to implement the infrastructure, according to the rule stated in the main clause of Art. 7 of Law no. 11.079/2004. Some changes have been observed ever since. On the one hand, the public sector got rid of - at least in

part - the difficulties of availability of resources for investment and, on the other hand, the funding of large economic and financial projects proved costly in many cases.

The problem was that, in cases where the authorities had resources to fund the construction-procurement of assets, they would be not be allowed to immediately transfer these funds to the private partner on account of consideration. This limitation would eventually discourage these authorities to chose the PPP model (alternatively using the conventional procurement system) in order to avoid the costs of capital financing. This scenario has required specific changes in the model that could alleviate the financial costs of PPP.

The rules aforementioned provide this very exemption by allowing any resources in case of administrations, to be immediately carried to the financing of construction equipment and reversible assets, even at the stage of construction/investment. The expansion-anticipation of the remuneration of the private partner in the early years of the concession can produce significant financial and tax effects: on the one hand, it reduces the need for the private partner to receive funding, with the elimination of a portion of the financial costs; on the other hand, it exempts the Government from future allocation of resources, with all the consequential tax effects.

The feasibility of including public resources in the remuneration of the private partner (of the SPE), with a view to provide financial benefits considered, was understandably associated with an adjournment of the payment of taxes on the contributions. This is because any concentration of public resources applied to the remuneration of the private partner in the phase of construction/investment could possibly increase taxes such as the PIS / PASEP, the Contribution to Social

Security Financing - COFINS, the Social Contribution on Net Profit, and IRPJ, Corporate Income Tax. Given the lack of synchronization between revenues from the SPE - concentrated at the beginning of the concession - and the realization of cost depreciation of certain reversible assets - diluted over the maturity period of the concession - the taxation of income and social contribution taxes would eventually produce increase taxation significantly. Thus, it would be of little help to relieve the project financially by the introduction of contributions at the early stages of the PPP contract if a significant portion of these gains were absorbed in increased taxation. This justifies the systematic adjournment of four relevant taxes provided by § 3 and § 4 of article. 6 of Law no. 11.0709/2004.

5.4.2 PERFORMANCE-BASED REMUNERATION OF THE CONCESSIONAIRE

Under § 1 of Art. 6. Law no. 11.079/2004, the PPP settlement may provide for the payment variable performance-based remuneration to the private partner according to goals and standards of quality and availability defined in the contract. The Law allowed the allocation of quality and availability risks to the concessionaire of PPPs.

Linking the remuneration of the contractor to fulfill certain goals and quality levels as a legal technique is not alien to the system of administrative procurement in Brazilian law. Both in general administrative contracts (Law no. 8.666/93) and in common public service concessions (Law no. 8.987/95), this is legally possible.

It is true that, although feasible, the technique is not common in the practice of general administrative contracts. The configurations involving remuneration variables based on

the performance of the contractor are rare. Perhaps this happens because the discipline of Law. 8.666/93 is configured from mechanisms that ensure that the Government can have effective control over the means employed by the contractor for executing the contracts, and this (control of the means) is a "philosophy" underlying the model[19].

In the field of concessions, more usual remuneration settings are those which are supposed to meet certain targets as regards quality and availability of the concessionaire. It should be noted that the provision of certain portions of the service may imply the collection of fees by the concessionaire, and the achievement of certain levels of efficiency and quality (also fulfilling universal service goals) can be considered a contractual condition for applying a readjustment or deflator incident on the revenue (fee) of the concessionaire[20].

The measurement-evaluation of the performance of the private partner for the purposes of controlling the corresponding remuneration should be based on objective criteria stipulated in the call for bids and the PPP contract, as established by Section VII of art. 5 of Law 11.079/2004. This is a matter of no small importance, because it is associated with degree of discretion of the public authorities, which produces direct effects on transaction costs. Not only regarding the criteria and factors for measuring the performance of the private partner,

19. Admittedly, however, there is a trend to favor this type of remuneration even in ordinary procurement. This is evidenced by the collection of performance--based remuneration for administrative contracts under the (forthcoming) *Differential Public Procurement Regime* for the World Cup in 2014 and the Olympic Games in 2016, in accordance with (still pending presidential approval) PM n. 527 (art. 4, Section IV, art. 10).

20. Refer to Section III of art. 23 and Section X of art. 29 of Law no. 8.987/95.

but also in terms of procedures of supervision and control, specific and detailed provision is required in the call for bids and the contract, with all relevant information made available to the private partner[21]. Furthermore, the criteria shall be defined objectively (avoiding excessive assessments based on degree of discretion) and the procedures for measurement and analysis shall have sufficient transparency.

5.5 IMPLEMENTATION OF A PPP BY MEANS OF A SPECIAL PURPOSE ENTITY (SPE)

Unlike the discipline of Law no. 8.987/95, which gives the Government the choice to demand the creation of an independent entity to perform common public service concession (provided that it is provided for in the call for bids - art. 20 of Law no. 8.987/95), this solution is mandatory in this regime of PPP. The Law has established that, before concluding the PPP agreement, a special purpose entity (SPE) shall be constituted and made responsible for implementing and managing the purpose of the partnership (art. 9. of Law no. 11.079/2004). Regardless of whether or not the winning bidder of the event is set up as a consortium of companies, it shall constitute an SPE in order to establish and manage the partnership.

The goal of this provision is to avoid the interference from other business pursued by the private partner on the management and implementation of the PPP contract, and to encourage more specific control over the performance of the partnership. The allocation of specific and exclusive purpose to the company responsible for managing and fulfill the purpose of the partnership not only protects the scopes of the partnership

21. Refer to Sections VII and XIII of art. 23 and art. 30 of Law no. 8.987/95.

against other interests and businesses potentially involved in the wider business performance of the private partner, but also favors a more specific control over management, enhancing transparency and access (by the Government and by other instances of control) to the financial and accounting statements, etc. associated with the performance of the PPP contract.

The SPE may take, in principle, any corporate legal form, under the law. It also can, as expressly provided in § 2 of art. 9 of Law no. 11.079/2004, take the form of a public company with securities admitted to trading market. In this capacity, it takes a format whereby funding is also fostered from the sale of shares on the stock exchange.

It should be noted that the Government is not allowed to securitize the majority of the voting capital stock[22] of the SPE in PPP settlements, excepting only the chance to acquire a majority of the voting capital stock of the company by a financial institution controlled by the government in case of default of financing contracts (§ 4 of art. 9. of Law no. 11.079/2004). With such provision, the specific law removed the legal possibility that the (direct and indirect) Federal authorities may become a private partner in PPPs.

Understandably, the only exception to this rule is the event of a financial institution controlled by the government which has participated by funding the project. In this case, there will not exactly be a condition originating from the private partner assumed by one Government entity, but the condition of a third funder of the project, which is integrated into the SPE due to default incurred by borrowers (step in rights). It is an

22. It should be noted that this does not prevent the Government from being the holder of the SPE by means other than the ownership of the majority of the voting capital.

event of transfer of control of a special purpose entity to its lenders, according to the conditions of the PPP agreement, in order to promote its financial restructuring and ensure continuity of service provision.

5.6 DISCIPLINE ON THE FINANCING OF PPPS

PPPs, as a rule, shall have a peripheral relationship (to the concession) between the private partner and the project--financing institution involved in the concession, with effects that reach the public partner. The financing institution will be the one responsible for financing a PPP project, which is carried out through a legal relationship with the private partner (whose format shall vary)[23].

In order to strengthen the legal security of the lender - and, consequently, reduce costs of fund-raising - the legislator admitted that the PPP contract stipulates certain prerogatives to safeguard the lender against the default of the private partner. Under § 2 of art. 5 of Law no. 11.079/2004, the PPP contract may provide for (i) the requirements and conditions whereby

23. There is an important aspect to be noticed about the cost of financing in PPPs. It is true that the state has the capacity of direct funding at lower costs than the private sector. Funds raised through the issuance of Treasury bonds, for example, result in significantly lower interest rates than those charged in the private market. This means that PPPs can prove a more costly financing technique, from this angle, because the costs that the private partner bears for fund raising in the private market are transferred to the public partner. In this context - as recalled by MARCOS BARBOSA PINTO – the participation of state financial institutions (such as the BNDES - National Bank for Economic and Social Development) is important in financing PPP projects, because they can lend at rates equal to or lower than those applicable to securities issued by the National Treasury. Refer to "A função econômica das PPPs, In Revista Eletrônica de Direito Econômico, Salvador, Instituto de Direito Público da Bahia, no. 2, May-Jun-Jul, 2005, available on the internet at www.direitodoestado.com.br. Accessed on July 5, 2011.

the public partner may authorize the transfer of control of the special purpose entity to its lenders, in order to promote its financial restructuring and ensure continuity of service provision (step in rights clause), and (ii) the possibility of issuing a note of commitment on behalf of the lenders of the project in relation to the financial obligations of the Government and (iii) the legitimacy of the lenders of the project to receive compensation for early termination of the contract, as well as payments made by the funds and state enterprises which are guarantors of public-private partnerships.

Some of these guarantees, such as the step in rights, are already relatively recurrent in recent Brazilian experience with concessions. However, Law no. 8.987/95 does not provide for this circumstance, which can raise doubt and debate about the appropriateness of this event and also of a presumed subjective transfer of the concession to the lender - which would contravene the principle of bidding. Even if the argument is clearly unfounded - in the face of evidence that taking control of the SPE does not change the subject of the concessionaire - the fact is that, although it is a provisional rule in nature, its affirmation provides greater legal certainty to the pact, which contributes to reducing incident transaction costs. The inclusion of these guarantees under the PPP contract inevitably produces a reduction of the credit risk of the private partner and the actual cost of fund-raising. Funding is, thus, relieved, and the Government and service users gain benefits.

It can also be observed that the law explicitly stipulated as a mandatory clause of the PPP contract that the private partner shall share with the Government effective economic gains earned by the former, resulting from reduced credit risk of loans used in the PPP (art. 5, IX, Law no. 11.079/2004). This

provision lies in a tendency to revise the cost of credit after the completion of the implementation phase of the infrastructure needed to provide early provision (and readily use) of the service (which assumes the completion of the construction phase of the required works). Since the consideration payable to the private partner will only occur after the delivery of the available service, as established in art. 7 of the Law, the period of construction and implementation of the necessary infrastructure to perform the services may naturally pose the greatest risk to the lender, which results in higher rates. Therefore, there is a tendency to revise the rate of credit (due to the reduction of credit risk) after the completion of the construction works or implementation of the service. The aim of the legislator, therefore, was that any savings experienced by the private partner because of the reduction of the credit risk shall be shared with the public partner.

5.7 DISTRIBUTION OF RISKS IN PPPS

One of the key instruments to increase efficiency in administrative contracts of PPP is the appropriate distribution of risks (including those so-called extraordinary ones) between the public partner and the private partner. The event is provided for in Brazilian law by Section III of Art. 5 of Law no. 11.079/2004. It is also prescribed by Section VI of art. 4 of the same Law as a guideline to be followed by the Government for structuring and scheduling PPP settlements[24].

The PPP contract should provide a specific and detailed description of shared risks. As risk taking translates into an

24. For further information, refer to Vernalha Guimarães, Fernando. "A Repartição de riscos em contratos de Parceria Público-Privada", *In Revista de Direito Público da Economia* n. 23. Belo Horizonte: Fórum, 2008.

economic clause of the contract, it is essential that there are very specific details of this risk-sharing to make the interested party properly aware of it. It should be noted that the lack of clarity in the description of such risks shall increase the transaction costs[25], which will ultimately increase the offers to the Government (since the insecurity of a contractor with respect to certain future contingency is always priced in their supply - and as a rule, referenced by a pessimistic scenario). Therefore,

25. The notion of transaction cost refers to the thinking of Ronald Coase, one of the main influences of Economic Analysis of Law and the New Institutional Economics. The theme gained prestige with Coase in the 1937 study named *The Nature of the Firm*, which earned him the Nobel Prize for economics in 1991. The economist stressed the impossibility of understanding the economic system when ignoring the costs incurred to carry out market transactions. The firm, integrated and composed of a bundle of contracts, tends to internalize or externalize contractual relations from an analysis of transaction costs. In other words: the use of procurement through the market or by the internalized production (firm) does not depend solely on an analysis of production costs, but the consideration of the costs involved in transactions. If transaction costs have to be high, there is a tendency to internalize the firm's contractual relations. Reversely, the agent will choose by market relations in a context of reduced transaction costs. Coase, Ronald. *The Firm, The Market and The Law*. Chicago: The University of Chicago Press, 1992, p. 33 and following pages.
One of the warnings that resulted from the work of Coase is, therefore, the recognition that the understanding of the economic system, or the definition of economic policies, cannot dispense with the examination of the issue of transaction costs. On the Theory of Contract, the notion of transaction costs gets a generous use, making them correspond to three main causes, in the words of FERNANDO ARAUJO: (i) costs of wording of clauses (cost of complexity), (ii) costs of contractual discipline, and (iii) unforeseen contingencies. Applied to the administrative contract, the Transaction Cost Economics takes into consideration, then, the whole of the costs associated with reaching these settlements. In this context, one of the main factors influencing transaction costs, which is associated with maximizing administrative efficiency in contractual relations, is the safety of the institutional and legal environment surrounding the contract. *Teoria Econômica do Contrato*. Coimbra: Almedina, 2007, p. 198.

it is essential that as much as possible, the description of risks to be shared is as detailed as possible

It should also be noted that the distribution of risks is not a random expedient. The PPP Law imposes a guideline of efficiency to guide this sharing (Article 4, Section I). According to their nature, risks are allocated to the party able to reduce the chances of materialization of risks at a lower cost, or, if this is not possible, mitigate the resulting damage. Certain risks are supposed to be assigned to the party that has more control over its management or over the consequences of its materialization[26].

By assigning risks to the party that can manage them at a lower cost, resources are saved for society. Efficient risk sharing makes PPP contracts less costly[27]. Therefore, the public partner should not retain risks that the private partner can manage at a lower cost (e.g. certain construction risks that can be prevented through a contract of insurance or other instruments of prevention[28]), or transfer them when there is not an adequate control over them by the private partner (e.g. the risk of rise in taxes).

26. Often, the private party is better able to find solutions for prevention of certain risks (which include security) than the Government. This can help save *ex ante* economies (by means of the expertise of the contractor in adopting effective preventive measures) and *ex post* economies (by minimizing the costs of materialization of the risk, compared to the shift of responsibility to the insurance entity) under the contractual relationship.

27. For further information, refer to the interesting study by Marcos Barbosa Pinto. "Repartição de Riscos nas Parcerias Público-Privadas", *In Revista do BNDES*, v. 13, n. 25. Rio de Janeiro: BNDES, 2006, p. 168.

28. One example is the risk of *premature wear of the asphalt* in the context of a sponsored road concession. The private partner may, for example, obtain insurance to avoid this problem or resort to preventive measures such as the installation of scales to regulate the transit of heavy vehicles on the highway (which is presumably a major cause for the premature wear of the asphalt).

5.7.1 THE DISTRIBUTION OF UNPREDICTABLE RISKS AND THE CONSTITUTIONAL PRINCIPLE OF MAINTENANCE OF THE ECONOMIC-FINANCIAL EQUATION OF THE CONTRACT

From a legal point of view, it is important to clarify that the constitutional principle of the inviolability of the financial equation in Brazilian law does not prevent the sharing of extraordinary risks in the PPP.

In the statement of Section XXI of art. 37 of the Constitution there is only a rule that imposes, in administrative procurement in general, the maintenance of the "effective conditions of the proposal[29]." This does not restrict, in particular, the pre-contractual space, in the sense of legally inhibiting the parties' ability to enter into a pact of distribution of unpredictable risks, providing for a division of responsibilities regarding contingencies associated with the execution of the contract.

The constitutional rule only ensures the inviolability of the conditions laid down in the proposal, protecting the pact of interventions and subsequent changes in the sphere of the economic clauses of the contract. It does not, however, impose any restriction on the free provision by the parties on the sharing of responsibilities for risks (which may result in the allocation of risks between the ordinary and extraordinary parts). Therefore, the rule of Section III of Art. 5 of Law no. 11.079/2004 is perfectly valid and compatible with the Constitution.

29. "Except where otherwise stated by law, works, services, procurement and disposal of assets shall be contracted by public bidding process to ensure equal conditions to all bidders, with clauses that establish payment obligations, maintaining the effective conditions of the proposal under the law, which only allow the requirements of technical and economic qualifications indispensable to guarantee the fulfillment of the obligations."

5.8 THE SYSTEM OF GUARANTEES OF PPPS

Because PPPs are large, long-lasting economic-financial contracts, they depend on the provision of guarantees so that the obligations of the partners can be fulfilled and, thus, there can be the adequate legal certainty for efficient stabilization of their effects. In this respect, one of the points of great importance in the construction of the legal regime of the PPP was to strengthen the legal security of such contracts by creating a very specific system of guarantees in order both (i) to safeguard the public partner as to any damage caused by the private partner under the partnership agreement; and (ii) to safeguard the private partner in the face of possible defaults incurred by the public partner.

5.8.1 GUARANTEES TO THE PUBLIC PARTNER

It is known that cautionary guarantees from the Government are conventional requirements of any public contract of a certain economic-financial dimension. Section VIII of art. 5 of the Brazilian PPP Law establishes, as a necessary clause for the settlements in PPPs, the prediction regarding the provision by the private partner, of the guarantees of execution sufficient and consistent with the burden and risks involved, within the limits of § 3 and §5 of article. 56 of Law no. 8.666/93, and, in the case of sponsored concessions, the provisions of Section XV of art. 18 of Law no. 8.987/95.

The guarantees of the public partner consist, therefore, of a mandatory clause of the PPP contract. Unlike the regime of general administrative contracts, which leaves at the discretion of the public authority to establish guarantees on an individual basis, the legal treatment of PPPs requires the prediction of the guarantees of the public partner in all cases, calibrated under

specific rules applicable to the administrative concession[30] and the sponsored concession.

5.8.2 GUARANTEES (TO THE PRIVATE PARTNER) AS TO THE PECUNIARY OBLIGATIONS OF THE PUBLIC PARTNER

As regards guarantees, the General Law of PPP went beyond the treatment traditionally accorded to administrative contracts in general and foresaw the possibility of instituting safeguards to the private partner, in order to warn them in case of defaults of the public partner.

Art. 8 of Law no. 11.079/2004 provided for the modalities of guarantees of the financial obligations incurred by the Government in the PPP, such as: (i) earmarking of revenues (as described in Section IV of art. 167 of the Federal Constitution), (ii) creation or use of special funds provided by law, (iii) employment of surety bonds with insurance companies that are not controlled by the government, (iv) guarantees provided by international organizations or institutions that are not controlled by the Government; (v) guarantees provided by state guaranty fund or company created for this purpose, and (vi) other mechanisms permitted by law.

As noted, the list is not exhaustive, but merely illustrative. The prediction of Section VI, as "other mechanisms permitted

30. For administrative concessions, section VIII of art. 5 of Law no. 11.079/2004 explicitly refers to the requirement of performance security by the private partner to the limit set forth in § 3 of art. 56 of Law n. 8.666/93, which, referring to § 2 of the same article, provides that "for works, services and supplies in large projects involving high technical complexity and considerable financial risks, demonstrated through a technical report approved by the competent authority," the ordinary limit of guarantee of 5% of the contract value - provided for in paragraph § 2 of article - may be increased up to 10% of the contract value."

by law," indicates the *numerus apertus* character of the relationship. It is assumed, thus, that other types of guarantees provided by law are used by the Government in PPP contracts. In this regard, one must admit, except for the obstacles imposed by Public Law, the Government's appeal to all legal techniques of guarantee provided by private law.

Guarantees will be executed after the verification of the default of the public partner, which must be established in the partnership contract. According to Section VI of art. 5 of Law no. 11.079/2004, PPP contracts should provide "the facts that characterize the default payment of the public partner, the modes and the term for the regularization and, if applicable, the mode of enforcement" (section VI). The contract should contain, thus, not only the characterization of the conduct that depicts the monetary default of the public partner, but also the moment when the guarantee may be "enforced" and the procedures that will govern such enforcement.

It should be noted that, unlike the guarantees provided by the private partner, the guarantees offered by the public partner will not be a clause required in PPP contracts; they will be viable, but not mandatory, and they may be established depending on the agreed settlement of the PPP.

Nevertheless, considering the application of the guidelines for efficiency and economy in the fulfillment of the duties of the State (Article 4, Section I), the guarantees to the private partner may be defined, in many cases, as giving the administrative contract a more efficient format. One of the reasons for the design of the model of PPPs lies precisely (as discussed above) in attracting private capital to finance infrastructure projects. A system of guarantees that can ensure the private partner has more rapid and predictable ways as to recover fi-

nancial losses incurred before the default of the public partner will strengthen the legal certainty and reduce transaction costs, making procurement more economical and advantageous to the Government.

Therefore, the provision of guarantees to the private partner can be a relevant part in setting an efficient settlement, following a guideline of efficiency and economy in the preparation of PPPs (Section I of Art. 4 of Law no. 11.079/2004).

5.8.2.1 GUARANTEES OFFERED BY A GUARANTEE FUND OR STATE COMPANY CREATED FOR THIS PURPOSE

One of the main innovations of the guarantee system introduced by the PPP regime is the anticipation of a state guarantee fund or company created to guarantee the obligations of the public partner. In this mode, autonomous entities associated with the Government, endowed with their own patrimony and legal entity of private law[31], guarantee the financial obligations of the public partner in the event of default at the expense of the private partner. While the federal model of PPP decided to set up a guarantee fund (FGP)[32], as can be seen in articles 16 to 21 of Law no. 11.079/2004 (rules applicable to the Federal

31. This statement assumes the existence of two kinds of funds: (i) those which are not legal entities and have accounting purposes only, and (ii) those which are legal entities and may be the subject of rights and obligations. For the latter, their legal entity can be of public or private law, depending on the law which established the fund. It seems to me that the guarantee funds of the PPP were designed (and intended) for being entities of private law. However, it is not totally unlikely that such funds may become legal entities of public law.

32. Refer to Resolution n. 1/2005, issued by the Steering Committee of Federal Public-Private Partnerships, which provided for the Guarantee Fund for Public--Private Partnerships - GFP.

Administration), other entities such as the State of São Paulo, opted for the solution of a state-owned guarantor of the financial commitments of the public partner[33].

As these entities shall have legal personality of private law (at least as a rule, since there is no impediment to guarantee funds having the nature of public law) – no changes have to be made to the relationship between legal entities of public law provided for in Article 41 of the Civil Code – their assets will be private, in compliance with the provision of art. 98 of the Civil Code. Therefore, they can be freely sold or pawned, and shall not be subject, therefore, to the legal regime of public assets, where restrictions to these measures apply.

Hence this type of guarantee offers (the private partner) the advantage of avoiding the special procedure for implementing debt enforcement under judicial orders in the event of default of the public partner. This is because these entities, with legal personality under private law, are subject to the special legal regime of private entities, and their debts will be enforced along the lines of common civil enforcement (under the terms of the CCP). By avoiding judicial orders, PPP contracts become safer (for the private partner and the lender), because transaction costs are reduced and PPP procurement becomes less costly.

5.8.2.1.1 CHARACTERISTICS OF THE GUARANTEE FUND

Although there are several funds in Brazil, with or without legal personality, the circumstance of the guarantee fund provided for in Section V of article 8 of Law no. 11.079/2004

33. As provided in State Law No. 11.688/2004 and Decree No. 48.867/2004 governing Companhia Paulista de Parcerias – CPP.

is truly an innovative solution to the administrative procurement, especially because it comes attached to a certain type of contract. I do not exactly refer, here, to the guarantee fund provided in the special part of the Law (established to safeguard PPPs held by federal public partners), but the in the abstract hypothesis of PPP guarantee funds entered in Section V of article 8.

The guarantee fund of PPPs can be defined as a state entity (created in the sphere of decentralization of certain authorities), whose creation is to be preceded by legislative authorization, with legal personality (as a rule, under private law), with the objective of materializing the reservation of certain assets in order to ensure the financial obligations of the Government in PPP settlements.

The guarantee funds may have their equity paid by individuals and also by administrative entities which are associated with them (as was the case of the GFP, which allowed, by Law no. 11.079/2004, the Federal Government, their agencies and foundations, to participate up to the limit of BRL 6 billion).

It is worth noting that the guarantee fund was not described in detail by the general rules. Law no. 11.079/2004, in the sections where it focuses on the general rules, has not described the core features of the guarantee fund in detail. Thus, the law creating these funds shall describe their particular features.

5.9 BIDDING AND PPPS

Except for exceptional circumstances of unenforceability, PPPs are always preceded by bidding. Law no. 11.079/2004 provided for a specific treatment to the bidding process for PPPs, slightly different from the bidding regime applicable to general or ordinary administrative contracts (Law no.

8.666/93) and (common) public service concession contracts (Law no. 8.987 / 95)[34].

5.9.1 PROVISIONS RELATING TO INTERNAL STAGES OF THE BIDDING PROCESS

Within the internal stage of the bidding process, Law no. 11.079/2004 brought a repertoire of rules applicable to PPPs (according to Sections of art. 10), aimed at protecting the Government for errors and flaws while preparing the contracts.

First, it was observed that the opening of the bidding process that will lead to the procurement in public-private partnerships is subject to an authorization signed by the competent authority duly substantiated by technical studies that demonstrate "the convenience and timeliness of procurement, by identifying the reasons justifying the choice of the form of public-private partnership "(a, I, art. 10, Law no. 11.079/2004). This is required not only for the use of the PPP model, but also as to the stipulation of the actual content of the settlement, as regards the configuration concretely applied to it. It is evident that these decisions are supported in technical premises and are the result of studies and actual checks.

It is imperative to sufficiently demonstrate these comparisons - especially between the PPP model and other models of procurement or other means to satisfy the needs of the authorities. One conclusion is that, similarly to what is known in Anglo-Saxon law as *value for money*, the real option for PPP is the best way to add value to public money.

34. Refer to Normative Instruction n. No. 52, of July 4, 2007, from the Brazilian Court of Audit, which provides for the control and supervision of bidding and procurement procedures, and the implementation of PPP contracts, to be exercised by the Brazilian Court of Audit.

On the other hand, the provisions of Sections I, II, III, IV and V of art. 10 of Law no. 11.079/2004 prescribe requirements aimed at demonstrating responsible fiscal management in the use of PPPs. These rules ensure the control over the use of public funds in PPP programs by monitoring the side effects in the broader fiscal management by the Government. This involves prospective analyses, which must be stated at the opening of the bidding process of the PPP. These requirements consist of the following steps: (a) preparation of budgetary and financial impact estimates for the term of the contract of public-private partnership; (b) statement of the originator of the expense that the obligations assumed by the Government in the course of the contract are consistent with the law of budgetary directives and are provided for in the annual budget law, (c) estimation of the flow of public resources sufficient to fulfill, during the term of the contract and the respective financial year, of the obligations undertaken by the Government, (d) demonstration that its purpose is planned in the multiannual plan in force under which the contract will be concluded.

Moreover, an environmental license or published guidelines are required for the environmental licensing of the project, in the form of the regulation, whenever required by the purpose of the contract.

5.9.1.1 THE LACK OF REQUIREMENT FOR A DETAILED BASIC PROJECT DESIGN

It should also be observed that, for engineering works, there is no need, in the discipline of PPP, for the Federal Administration to provide a basic project design in extensive detail - as occurs, for example, in the sphere of general administrative contracts (Section of § 2 of the art. 7, and Section IX of art. 6 of

Law no. 8.666/93). Suffice it to present a draft project design pursuant to § 4 of art. 10 of Law no. 11.079/2004, introduced by Law no. 12.766/2012. According to the rule, "engineering studies to define the investment value of the PPP should be as detailed as a draft project design, and the value of investments for setting the reference price for the bid will be calculated based on market values considering the overall cost of similar works in Brazil or abroad, or based on cost systems whose inputs are market values of the specific sector of the project, measured in any case, by a brief budget developed through a expeditious or parametric methodology."

The rule contains a definition relevant to the delimitation of the studies required to setup the key elements of the basic project – although, in principle, they are specifically devoted to quantifying the budget and not necessarily to the delimitation of the executable amount by the private partner.

From the point of view of risk allocation, the goal of the legislation of PPPs, in this case, seems to be that of transferring to those in charge of implementing and managing the work for a long term (the concessionaire) the risks posed by the design of the project. Based on the essential elements of the project described in the bid, and in order to meet the goals, parameters and results required for the service, the project will be customized by the concessionaire, who will take (at least partly) the risks of operation and administration of the enterprise. Thus, the mismanagement of the project shall imply in higher costs for maintenance of the works and vice-versa. The Federal Administration may gain efficiency and avoid even opportunistic behaviors of the concessionaire should they attempt to transfer to the Government the responsibility for constructive and functional problems associated with the works (for alleged

project flaws). It creates, then, an extremely interesting incentive structure (bundling), whereby the responsibility of the private partner lies in project design risks, construction risk, and also in the long-term management-maintenance of the project – depending on the risk allocation defined in the contract.

5.9.1.2 CEI – CALL FOR EXPRESSION OF INTEREST

The Call for Expression of Interest (CEI) is the instrument by which private parties formalize their interest in proposing studies, designs and solutions for the Government, aiming at structuring a prospective concession project or PPP. It is a circumstance of transparent dialogue between the public and private sectors, harmonized with the legal and institutional environment currently experienced.

The CEI can originate either from public solicitation - an act that establishes a public call for individuals from the private sector to present studies, projects, surveys, investigations etc. - or, in some cases, depending on local regulations, from spontaneous and independent application by private parties[35] - in which case their subsequent processing will require a public call, in order to ensure publicity and give the opportunity for other interested parties to express equivalent propositions.

The natural course of proceedings of a CEI comprises the steps of (i) disclosure of the request and call for contributions from private parties, (ii) analysis of the contributions and definition of the selected project, and (iii) development and use of the contribution and definition of the compensation for the

35. The regulation provided by the State of Paraná (Decree No. 5273), for example, distinguishes between unsolicited CEI established by the applicant public authority, and intentional CEI, which originates from the manifestation of private parties.

private party by the transfer of rights over the project. If successful, the CEI will help to guide and subsequently structure a bidding process for a PPP or concession.

As a rule, the CEI will not create any obligation for the authorities concerned until the choice and approval of the contribution offered and authorized by the interested private party have been formalized. In this case, and before the (full or partial) use of the contribution that shall guide and structure the procurement process of the PPP or concession, there is an obligation for reimbursement to the private partner to be provided by the Government or by the winning bidder whose bid shall result in the PPP, as long as it has assumed the corresponding commitment for compensation required for the bidding. Such definitions depend on how the CEI is regulated by each authority in the respective federated sphere.

5.9.1.3 NORMATIVE DISCIPLINE OF THE CEI

The CEI is admitted by the statutory discipline of concessions (Law no. 8.987/95) and of PPPs (Law no. 11.079/2004), but it is not admitted under the terms of Law no. 8.666/93, precisely due to the prohibition contained in Art. 9, Section I.

It should be noted that Article 31 of Law no. 9.074/95 admitted that the authors or those economically responsible for the basic and executive project designs shall compete bids for concessions and resulting licenses. Likewise, Article 21 of Law no. 8.987/95 establishes that the studies, investigations, surveys, project designs, works and expenditures or previous investments, associated with the concession, useful for the bids, made by the grantor or with their permission, will be available to interested parties, and the winning bidder shall reimburse the corresponding expenditures, as specified in the call for bids.

Such provisions are fully applicable to PPPs, under the main clause of § 1 of Art. 3 of Law no. 11.079/2004. As noted, they are generic rules and do not enforce a more specific discipline about the issue. The exact definition and delimitation of the appropriateness and processing of the CEI are found in the infralegal discipline, to be provided by each federal entity.

At the federal level, the Decree No. 5.977/2006 regulated the main clause and § 1 of Art. 3 of Law no. 11.079/2004, establishing criteria and requirements for the CEI. Conditions were predicted by the authorities for requesting from private parties, projects, studies, surveys and investigations by the authorities (which in the federal case, is done by means of the Steering Committee of Federal Public-Private Partnership - CGP). Contrary to what is assumed in other spheres[36], the Federal Decree restricted the expression of interest by private parties in the authorization procedure subject to a procedure for the public request for studies and projects. As described in § 2 of art. 3, authorization requirements will be refused if they have not been previously requested by the CGP or have been submitted in violation of the scope of the solicitation.

Under the Decree, the request by the Administration was conditional on the compliance with some assumptions and parameters, such as (i) defining the scope of projects, studies, surveys and investigations, which may merely indicate only the problem whose resolution is the goal of the partnership, and give the private sector the opportunity to suggest different ways for their resolution; the (ii) specification of the ultimate deadline for submission of projects, studies, surveys and inves-

36. In most states, the regulation of CEI admits allows for either a public call or unsolicited application by private parties.

tigations and the maximum nominal value for possible reimbursement; (iii) an indication of the maximum value of the public consideration admitted to public-private partnership in the form of a percentage of the value of total revenues of any private partner, and (iv) publication of the request in the Official Gazette and, when deemed appropriate, on the internet and in newspapers of wide circulation.

As is the case for the Federal Government, many states have issued their regulations regarding the CEI. This is the case, for example, of the states of Minas Gerais (Decree 44.465/07), Ceará (Decree 30.328/10), Rio de Janeiro (Decree 43.277/11), Bahia (Decree 12.653/11, as amended by Decree 12.679/11), Espírito Santo (Decree 2.889/11, as amended by Decree 2889-R), Sao Paulo (Decree 57.289/11), Paraná (Decree 5.273/12), Santa Catarina (Decree 962/12), among others.

5.9.2 EXTERNAL STAGE

After such statements and previous studies have been conducted, and the call for bids and the draft PPP contract have been prepared, this set of documents must be submitted to a public consultation procedure, for a minimum period of 30 days to receive suggestions, which should be made at least 7 days before the expected date of publication of the call for bids (Section VI of art. 10). It is an attempt to add more transparency and effectiveness to the participation of stakeholders, whose relevance is higher in contracts of this nature – given their complexity and length.

With regard to the external stage, although Law no. 11.079/2004 has adopted bidding as the mode of competition for PPP procurement, characteristics of trading have been incorporated into its processing (such as the possibility of phase inversion and open outcry.) The result is a customized proce-

dure which could be called competitive trading. But there is not detailed description for the development of the PPP bidding; therefore, the subsidiary application of the Law no. 8.666/93 and Law no. 8.987/95 shall take place.

Regarding the structure of the bidding process, it is observed that the law allowed a previous phase of qualification of technical proposals, which shall operate on the grounds of a cut score. Such qualification does not compose a qualitative judgment of the proposals, as happens, for example, in the evaluation of technical proposals under the application of the so-called types of technique. It is just a qualifying round, whose judgment shall eliminate proposals that do not meet the minimum score (and the bidders shall not carry that score for other purposes at the event[37]). The purposeive criteria for evaluation shall be provided in detail in the call for bids, in order to avoid excessively discretionary judgments by authorities. Furthermore, the qualification of technical proposals should be sufficiently motivated, under the law.

Also as regards the bidding structure, the inversion of the phases of qualification and judgment was allowed by law. In this case, after the classification of the proposals has finished, the only qualification documents analyzed are those of the bidder with the best economic proposition. If these documents are disqualified, the documents of the bidder with the second best proposition are analyzed, and this is done successively until a bidder is enabled, in which case they will be awarded the tender in the technical and economic conditions offered by them.

It is worth noting that the phase of examination of proposals may be followed by the examination of written proposals and a

37. This circumstance has a certain resemblance to the methodology of implementation provided in § 8 of article. 30 of Law no. 8.666/93.

subsequent open outcry phase. In this mode, the bids will always be offered in reverse order of the ranking of written proposals, and there is no limitation on the amount of bids (section II, § 1 of art. 12). The call for bids may restrict open outcry bids to bidders whose written proposal is, at the most, 20% greater than the value of the best proposal (Section II of § 1 art. 12).

Another particular aspect of the structure of bidding for PPPs is the possibility of a phase for correction of flaws in the structure of bidders' documentation (Section IV, Article 13). This possibility should be planned and disciplined in the call, including the respective time limit. The event covers the correction of effects on both the qualification documents and the proposal. The legislator made the correct decision when they explicitly incorporated the principle of moderate formalism into the discipline of PPP bidding.

Clearly, even if no discipline about it is explained in the call for bids, the authorities may also avail themselves of the provisions of § 3 of article 43 of Law no. 8.666/93 in order to overcome formal shortcomings of bidders' documentation. As long as equality is respected, it is relevant to allow the correction of minor flaws in the bid, so s not to undermine the ultimate purpose of the competition, which is to obtain the most advantageous bid.

Finally, as regards the selection criteria, the Brazilian PPP Law assumes, in addition to the criteria provided for in Sections I and V of the art. 15 of Law 8.987/95, the lowest value of the consideration to be paid by the Government, as well as the best proposal because of the combination of the criteria of the lowest value and the best technical expertise, according to the weights set out in the call for bids. Of course, the evaluations of the technical proposals shall be held from objective criteria explained by the call for bids, and their judgment should bring enough motivation, under the law.

Este livro foi composto nas fontes Georgia e Swiss 721 Cn,
com miolo sobre Off-set 90g, capa em papel supremo 250g, pela Gusto Editorial.

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